BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )
)
GILMORE OIL COMPANY )

Appearances:

For Appellant: Bayley Kohlmeier of the office of Claude I. Parker, its Attorney
For Respondent: Chas. J. McColgan, Franchise Tax Commissioner; C. T. Bondeson, Franchise Tax Auditor

## O P I N I O N

This is an appeal pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of Gilmore Oil Company to his proposed assessment of an additional tax in the amount of $4,315.42 for the taxable year ended March 31, 1935, based upon the income of the company for the year ended March 31, 1934.

The Appellant is a domestic corporation with its principal place of business in the City of Los Angeles, California, and is engaged in the business of selling crude oil and other petroleum products. The facts giving rise to the additional assessment involved herein, as stated in Appellant's opening brief, are as follows:

In 1931, Appellant acquired from the Howard Petroleum Corporation an undivided interest in oil leases in Texas then held by the latter corporation. Subsequently during 1931 Appellant sent one of its employees Mr. McFarland, to Texas to investigate the leases of the koward Petroleum Corporation, and while in Texas McFarland, acting on behalf of the Appellant and the Howard Petroleum Corporation, acquired certain other oil leases there, known as the Stuckey Thrasher and Davis leases. These leases were taken in the name of the Howard Petroleum Corporation, which, with the approval of Mr. McFarland, made contracts for the drilling of oil wells on the lease property and which carried on the operation of the oil leases, kept the accounts with respect thereto and at frequent intervals sent statements of said accounts to Appellant, which paid one-half of the expenses incurred in said operations and received one-half of the profits from the sale of the oil produced. In entering into any negotiations or contracts of importance, the Howard Petroleum Corporation first secured the consent and approval of Appellant.

During 1933 the Howard Petroleum Corporation sold certain of the leases, Appellant's share of the net profits from said

sales aggregating $264,168.95. Whether or not this sum should be included in the measure of Appellant's tax liability under the Bank and Corporation Franchise Tax Act for the taxable year ended March 31, 1935, is the sole question presented by this appeal.

The relevant statutory provisions are contained in Section 10 of the Act, and are as follows:

> "If the entire business of the bank or corporation is done within this State, the tax shall be according to or measured by its entire net income; and if the entire business of such bank or corporation is not done within this State, the tax shall be according to or measured by that portion thereof which is derived from business done within this State. The portion of net income derived from business done within this State, shall be determined by an allocation upon the basis of sales, purchases, expenses of manufacture, pay roll, value and situs of tangible property, or by reference to these or other factors, or by such other method of allocation as is fairly calculated to assign to the State the portion of net income reasonably attributable to the business done within this State and to avoid subjecting the taxpayer to double taxation."

It would appear that under the above provisions the precise question to be determined is whether or not Appellant's net profits from the sale of the oil leases is to be regarded as having been derived from business done by it in Texas. Appellant bases its position upon the assertion that all the transactions in connection with said leases took place in Texas, and contends in addition, and apparently as an entirely independent ground, that its interest under the leases constitut real property. It also relies upon the decisions of this Board in the Appeal of Howard Automobile Company, May 15, 1931, and the Appeal of Charles Harley Company, December 14, 1931. These appeals involved California corporations whose only offices and substantially all of whose property and pay roll was located in California but which made sales in other states of goods purchased elsewhere. It was held that these corporations were not subject to taxation by California with respect to their entire net income and that for purposes of computing the allocation formula the above mentioned sales were to be regarded as sales made in other states.

We believe, however, that the correct rule is that a corporation whose business is managed and directed from a place of business in California is subject to taxation with respect to its entire net income unless it is to be regarded as also doing business in other states. A review of judicial decisions passin upon the question of whether a corporation is doing business within a state for purposes of applying a state franchise tax indicates that a corporation is not doing business in a state unless there is a continuous course of business conducted on its behalf by its officers or employees located within the state.

Montag Bros., Inc., v. State Revenue Commission of Georgia, 179 S.E. 563, involved a corporation manufacturing goods in Georgia and selling them in Georgia and other states. Orders in other stateswere solicited by salesmen subject to confirmation at the head office in Georgia. The business was managed and directed from the Georgia office and all collections were made by that office, although the company maintained a sales office and samples in New York and had a bank account in New York and also maintained a sample room in Chicago for six months of each year.

Section 15 of the Georgia Income Tax Act of 1931 contained the following provision:

> "If the trade or business of the corporation is carried on entirely within the State, the tax shall be imposed on the entire business income, but if such trade or business is carried on partly within and partly without the State, the tax shall be imposed only on the portion of the business income reasonably attributable to the trade or business within the State..."

The corporation contended that its business was carried on partly without the State of Georgia, so that the Georgia tax did not apply to its entire net income. This contention was denied by the court in the following language, at p. 566:

> "The fact that part of the sales were made in interstate commerce, or that the title to some of the goods may have passed to purchasers outside the State, or even that some of the sale contracts might be taken as made outside the State, would not relieve the seller from tax upon the net earnings from such sales, where the manufacturing plant was located, the products were manufactured and owned, the shipments and payments were made, and every important step connected with the manufacture, distribution, sales, collection, and earnings occurred, in Georgia."

Buick Motor Company v. City of Milwaukee, 48 F. (2d) 801, certiorari denied, 284 U. S. 655, involved the validity of the Wisconsin income tax with respect to sales of automobiles by a Wisconsin distributor to a dealer to Michigan, the automobiles being shipped direct to the dealer from the point of manufacture in Michigan. The court found no merit in the taxpayer's suggestion that the sales made to Michigan dealers were not Wisconsin business and that the profit thereon was not includible in the Wisconsin returns. The court stated, at p. 804:

> "The sales were made through and by, and the remittances therefore made to, the Wisconsin branch at Milwaukee, and were in essence Wisconsin business."

It has also been held that a corporation is not doing business within a state, so as to be subject to a state franchise tax, by virtue of the fact that it owns property within the state (U.S. Rubber Co. v. Query, 19 F. Supp. 191; Norman v. Southwestern Railroad Co., Ga., 157 S.E. 571.) or that its produ

are sold in the state on a consignment basis by commission merchants. (So. Cotton Oil Co. v. Roberts, 25 App. Div. 13.)

The conclusion to be drawn from these authorities is that a corporation is not doing business in a state unless its officers or employees are present in the state conducting a substantial portion of its business there. Applying this principle to the instant case, we are unable to conclude that the Appellant was doing business in Texas, so as to have been subject to a franchise tax by that state on its profit from the sale of the oil leases, and consequently we feel that the entire amount of this profit is subject to taxation under the California Bank and Corporation Franchise Tax Act. From the record it does not appear that any of Appellant's officers or employees other than McFarland were ever in Texas, that McFarlan himself was at any time permanently located there, or that the Appellant took any part in the negotiation of the sale of the leases, except to give its approval at its home office in Los Angeles to the terms negotiated by the Howard Petroleum Company. Moreover, it does not appear that the Appellant has ever qualified to do business in Texas. Although a foreign corporation can be doing business in a state and yet not be required to comply with the corporation laws of that state by virtue of the fact that its business therein consists exclusively of interstate commerce, Appellant's transactions with respect to the Texas leases clearly do not constitute interstate commerce, so that a failure to qualify under the Texas corporation laws can hardly be held to be consistent with Appellant's contention that it derived income from business done in Texas.

In view of the foregoing, we feel constrained to hold that the Appellant has not sustained the burden of proving that the profits from the sales of the oil leases constituted income from business done outside the state.

## O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the action of Chas. J. McColgan, Franchise Tax Commissioner, in overruling the protest of the Gilmore Oil Company, a corporation, to a proposed assessment of additional tax in the amount of $4,315.42 for the taxable year ended March 31, 1935, based upon the income of said company for the year ended March 31, 1934, be and the same is hereby sustained.

Done at Sacramento, California, this 15th day of November, 1939, by the State Board of Equalization.

Fred E. Stewart, Member
George R. Reilly, Member
Harry B. Riley, Member

ATTEST: Dixwell L. Pierce, Secretary